

Before the
Illinois Commerce Commission

In the Matter of

Approval of an Increase and
Adjustment of Rates and Charges for
Water and Wastewater Utility Service Sold by
Northern Hills Water and Sewer Company within
Stephenson County

RECEIVED
MAY 20 2003

ILL. COM. COM. SEC. 1-1
STEPHENSON COUNTY

Direct Testimony of

Amanda M. Ross
Senior Regulatory Accountant

for

Northern Hills Water and Sewer Company

May 19, 2003

1 **Q. Please state your name and business address.**

2 A. My name is Amanda M. Ross. My business address is 2335 Sanders Road,
3 Northbrook, Illinois 60062.

4

5 **Q. What is your occupation?**

6 A. I am the Senior Accountant for the Regulatory Department of Utilities, Inc. and its
7 subsidiaries.

8

9 **Q. Please summarize your professional background?**

10 A. I have been employed by Utilities, Inc. since April of 2002. Since that time I have
11 been involved in many phases of rate-making in several regulatory jurisdictions. I
12 graduated from Purdue University in 2000, and I am a Certified Public Accountant.
13 I had two years of public accounting/financial analysis experience prior to joining
14 Utilities, Inc., and I am a member of the American Institute of Certified Public
15 Accountants.

16

17 **Q. Please explain your job responsibilities with Utilities, Inc.?**

18 A. My responsibilities include: financial analysis of individual subsidiaries of Utilities,
19 Inc., preparation of applications for rate relief, facilitation of commission audits,
20 and the submission of financial testimony and schedules to support a request for
21 an increase in rates.

22

23 **Background**

24

25 **Q. Please describe Northern Hills Water and Sewer Company.**

26 A. Northern Hills Water and Sewer Company is a wholly owned subsidiary of Utilities,
27 Inc. (UI). Water Service Corporation (WSC) manages the operation for all of UI's
28 water and wastewater systems, including Northern Hills. WSC provides
29 management, administration, engineering, accounting, billing, data processing, and
30 regulatory services for the utility systems. WSC's expenses are assigned directly to
31 a utility or distributed to the various companies pursuant to a formula that has
32 been approved by the Commission.

ILLINOIS COMMERCE COMMISSION
CHIEF CLERK'S OFFICE

1 Northern Hills provides water usage service to approximately 172 customers and
2 sewer collection and treatment service to approximately 186 customers in
3 Stephenson County. Northern Hills' current rate structure was approved pursuant
4 to Order No. 98-0045 dated October 21, 1998.

5
6 **Q. Ms. Ross, what is the purpose of your testimony here today?**

7 A. The purpose of my testimony is to explain to the Commission why Northern Hills
8 Water and Sewer Company has requested an increase in water and sewer rates. I
9 will also discuss some of the factors that have contributed to the need for the
10 increase and the impact of the increase on our customers. I will present and
11 describe schedules showing the overall cost of capital and proper rate of return on
12 rate base, and I will also sponsor the Utility's financial exhibits.

13
14 In addition, I will provide information to support Northern Hills' request to change
15 depreciation rates from composite rates to class-of-asset rates and to update the
16 Rules, Regulations, and Conditions of Service tariffs.

17
18 **Rate Relief**

19
20 **Q. Why is Northern Hills Water and Sewer Company requesting rate relief at this**
21 **time?**

22 A. A rate increase is necessary to allow the Utility to recover the reasonable and
23 prudent costs of providing service and an opportunity to earn a fair and reasonable
24 rate of return on its invested capital. Rates granted in 1998 do not reflect the 5
25 years of rising costs, many of which result from stringent federal environmental
26 regulations, increased investment, and inflation. For these reasons the Utility is
27 not able to achieve a reasonable rate of return on its investment. Rate relief is
28 essential to ensure the continued availability of capital at a reasonable cost and to
29 maintain a high and professional level of service. Under the present rate schedule,
30 Northern Hills is not earning a fair and reasonable return on its investment. After
31 making pro forma adjustments to the December 2002 test year for known, fixed
32 and measurable changes Northern Hills has an overall return of 3.01%. The
33 proposed rates will allow the company to earn a 8.36% overall rate of return. This
34 information is supported in the financial statements attached hereto as Utility
35 Exhibit One.

MAY 20 2003

CLERK OF THE BOARD OF SUPERVISORS
STEPHENSON COUNTY, ILL.

1 **9. Ms. Ross, what factors, or changes in the cost of service, can you point to**
2 **that have contributed to the need for the requested increase?**

3 A. The age of the system is a factor in the cost of maintenance to be done. As the
4 system ages, the cost of maintenance increases. In addition, the Utility plans to
5 repair the fence for the wastewater treatment plant in the year 2003. Northern
6 Hills is committed to maintaining clean, safe, professional facilities. Our facilities
7 are visible throughout the communities we serve.
8

9 **Rate Analysis**

10 **9. What are the present water and sewer rates for Northern Hills and when did**
11 **they become effective?**

12 A. The present water and sewer rates became effective on November 14, 1998, and are
13 as follows:

14 Water

15 Base Facility Charge: \$5.00

16 Gallonage Charge: \$2.84 per 1,000 gallons
17

18 Sewer

19 Base Facility Charge: \$21.23
20

21 The current average consumption for residential customers in Northern Hills is
22 approximately 5,259 gallons per month. This equates to a monthly bill of \$19.94
23 for water customers and \$21.23 for sewer customers.
24

25 **9. What are the proposed water and sewer rates for Northern Hills and their**
26 **impact on the average customer?**

27 A. The proposed rates are as follows:
28

29 Water

30 Base Facility Charge: \$6.25

31 Gallonage Charge: \$3.07 per 1,000 gallons
32

33 Sewer

34 Base Facility Charge: \$27.19
35

APPROVED BY THE BOARD OF DIRECTORS
MAY 20 2003
CITY OF NORTHERN HILLS
COUNCIL CHAMBERS

Based on the average consumption, the customers' monthly bill will be \$22.39, or an increase of \$2.45 per month, for water customers and \$27.19, or an increase of \$5.96, for sewer customers.

Cost of Capital

Q. What is the cost of capital of Northern Hills?

A. The cost of capital of Northern Hills is determined by using UI's capital structure. These cost of capital percentages are then used to ascertain the overall cost of capital for Northern Hills. The capital structure and cost rates that I proposed to use in this proceeding are as follows:

	<u>Weight</u>	<u>Cost</u>	<u>Weighted Cost</u>
Debt	59.76%	7.24%	4.33%
Equity	<u>40.24%</u>	<u>10.02%</u>	<u>4.03%</u>
Overall	<u>100.0%</u>		<u>8.36%</u>

Q. Why must one determine the overall cost of capital for a public utility?

A. The proper balance of rate payer and shareholder interest occurs when the Commission authorizes a public utility a rate of return on its rate base equal to its overall cost of capital. If the authorized rate of return on rate base exceeds the overall cost of capital, then rate payers bear the burden of excessive prices. Conversely, if the authorized rate of return on rate base is lower than the overall cost of capital, then the Utility will be unable to raise capital at a reasonable cost. Ultimately, the Utility may be unable to raise sufficient capital to meet demands for service, thereby impairing service quality. Therefore, ratepayers interest are served best when the authorized rate of return on rate base is neither higher nor lower than the overall cost of capital.

Q. Please define "overall cost of capital"?

A. The overall cost of capital equals the sum of the costs of the components of the capital structure (debt and common equity) after each is weighted by its proportion to total capital.

[Handwritten signature]
MAY 20 2003
ADMINISTRATIVE
OFFICE

1 **Q. How does Northern Hills raise capital?**

2 A. Capital for Northern Hills is raised by Utilities, Inc. Northern Hills is a wholly
3 owned subsidiary of Utilities, Inc. The source of this capital is banks and large
4 lending institutions

5
6 **Q. How did you determine the cost of debt to Northern Hills?**

7 A. The 7.24% cost of debt is the embedded cost of debt of the Utilities, Inc., the parent
8 company of Northern Hills, as of December 31, 2002. This percentage is consistent
9 with past Illinois Commerce Commission practice.

10
11 **Q. How did you derive the cost of equity used in your calculation?**

12 A. Today's embedded cost of debt of the consolidated group is approximately 7.24%.
13 The equity investor is entitled to a premium over the return to the debt holder
14 because of the additional risk he or she takes. The debt holder has first claim on
15 the assets and earnings of the Utility. These claims must be satisfied before funds
16 are available to the equity shareholder. Therefore, the return on equity must be
17 greater than 7.24%.

18
19 In addition, a risk free investment, thirty-year treasury bonds, currently yields
20 approximately 4.94%, as of April 15, 2003. Utility bonds available to investors are
21 a higher risk than government bonds. Also available to investors are equity
22 securities of large companies. These are publicly traded securities paying
23 dividends and having the advantage of liquidity. Naturally, the market would favor
24 any of these securities over the equity in a small company with non-traded
25 securities, such as Northern Hills. It would be reasonable to add a premium to the
26 cost of 30-year treasury bonds to determine the cost of equity to Northern Hills.

27
28 In addition, in the last rate proceeding (Docket #02-0592), Staff witness Rochelle
29 Phipps opined that 10.02% is a reasonable cost of equity for one of UI's operating
30 subsidiaries. In view of the proceeding information, I believe that 10.02% is the
31 minimum cost of equity and that an overall return of 8.36% is reasonable.

32
33
34

RECEIVED
MAY 20 2003

OFFICE OF THE ATTORNEY GENERAL
STATE OF ILLINOIS

1 **Depreciation**

2
3 **Q. What is the current method of calculating depreciation expense at Northern**
4 **Hills?**

5 A. Currently, Northern Hills multiplies all plant-in-service accounts by a composite
6 rate of 1.50% to calculate annual depreciation expense.
7

8 **Q. What method of calculating depreciation expense is the Utility proposing?**

9 A. The Utility is proposing a change from using a composite rate of 1.50% to utilizing
10 separate depreciation rates for each primary account. These rates range from
11 1.89% to 7.69%. This method of calculating depreciation expense is consistent
12 with prior rate proceedings approved by the Commission, including Docket No. 01-
13 0663, Lake Wildwood Water Company, and Docket No. 02-0592, Del-Mar Water
14 Company.
15

16 **Q. Why is Northern Hills proposing this change in depreciation rates in order to**
17 **calculate depreciation expense in this rate proceeding?**

18 A. The Utility has proposed these modified depreciation rates based on testimony filed
19 by Staff witness King in Docket Nos. 01-0663 and 02-0592. According to this
20 testimony, separate depreciation rates for primary accounts are more sensitive to
21 the service life and retirement in a specific account than a composite rate. As
22 such, rates by primary accounts result in a more accurate allocation and recovery
23 of depreciation expense. Therefore, the Utility's calculation of depreciation expense
24 was prepared using the average service lives, salvage values, and calculations
25 utilized in ICC Staff Exhibit 6.00, Schedules 6.01 and 6.02 for Docket No. 01-0663
26 and ICC Staff Exhibit 4.00, Schedule 4.04, pages 1 and 2 for Docket No. 02-0592.
27

28 **Q. How do the depreciation rates proposed by the Utility compare to the rates**
29 **approved by the Commission in prior rate proceedings?**

30 A. The depreciation rates proposed by the Utility are consistent with the average
31 service lives, salvage values, and calculations that were approved for Consumers
32 Illinois Water Company, Northern Illinois Water Corporation, Illinois-American
33 Water Company, Lake Wildwood Water Company, and Del-Mar Water Company.
34

MAY 20 2003

RECEIVED
MAY 20 2003

1 **Q. What is the effect on Northern Hills' depreciation expense using the proposed**
2 **depreciation rates?**

3 A. Depreciation expense of Northern Hills will increase by approximately \$3,279 for
4 water and \$2,746 for sewer based on proposed depreciation rates. In addition, the
5 overall composite depreciation rates will raise from 1.55% to 2.99%. This increase
6 is consistent with prior rate proceedings approved by the Commission. Please see
7 Utility Exhibit Two for details of the proposed depreciation calculation.
8

9 **Rules, Regulations, and Conditions of Service Tariffs**
10

11 **Q. Does the Utility plan to update the Rules, Regulations, and Conditions of**
12 **Service tariffs for Northern Hills?**

13 A. Yes, it does.
14

15 **Q. Please explain why the Utility is proposing to update Northern Hills' Rules,**
16 **Regulations, and Conditions of Service tariffs.**

17 A. The Utility has proposed to update its Rules, Regulations, and Conditions of
18 Service tariffs as they have not been updated in several years. Since this time,
19 Staff has compiled updated Rules, Regulations, and Conditions of Service tariffs
20 that have been provided to other Illinois regulated utilities, including Utilities, Inc.,
21 Northern Hills' parent company. Utilities, Inc. has filed updated Rules,
22 Regulations, and Conditions of Service tariffs for Docket No. 01-0050, Westlake
23 Utility, Inc. and has agreed to file these tariffs for Docket No. 02-0592, Del-Mar
24 Water Company. Please see Utility Exhibit Three for the proposed Rules,
25 Regulations, and Conditions of Service tariffs.
26

27 **Filing Procedures**
28

29 **Q. Why is Northern Hills filing under the Standard Rate Case Procedures instead**
30 **of the Short Form Procedures that are in place for a company the size of**
31 **Northern Hills?**

32 A. Utilities, Inc. has determined that our short form filings are conducted in the same
33 manner as a general rate filing. This is because Utilities, Inc. has a staff of
34 accounting and ratemaking professionals. Additionally, under the short form
35 process there is no formal procedure for seeking a mediation of disputed

1 adjustments made by the Staff to the Utility's revenue requirement. This can be
2 unfair to the Utility.

3

4 **Q. Does this conclude your testimony?**

5 A. Yes it does.

RECEIVED
MAY 20 2013

RECEIVED
MAY 20 2013